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Legend

Taxpayer =

State =

Trust =

Plan =

Dear :

This is in reply to your letter dated November 25, 2008 in which you request various rulings on behalf of Taxpayer with respect to Plan and Trust.

FACTS

Taxpayer is a municipality organized and existing under the laws of State. As a municipality, Taxpayer is a political subdivision of State.

Taxpayer adopted Plan as a means of providing health benefits to its eligible retirees, their spouses, and eligible dependents. The Plan is a multiple-employer welfare plan sponsored by the State employee's insurance board. The State employees' insurance board is authorized to amend or terminate Plan.

Plan is a multiple-employer self-insured welfare plan. Under Plan, Taxpayer pays a portion of the premium for health insurance coverage for eligible retirees. Participants are responsible for the remainder of the premium.

Taxpayer represents that there are no pre-tax salary reduction elections under Plan. In addition, Taxpayer represents that Plan does not permit a cash-out of unused amounts or a conversion of sick or vacation days to retiree health benefits. Participants may not salary-reduce to pay for any benefit. Taxpayer does not currently provide benefits to individuals who do not qualify as a spouse or as a dependent under § 152 of the Internal Revenue Code (the Code).

Taxpayer created Trust to provide a vehicle for funding retiree health benefits under Plan. The income of Trust consists solely of contributions from Taxpayer and investment income. No contributions will be made to the Trust by employees; rather, employees pay a portion of the premiums to Taxpayer. No part of Trust may be diverted to purposes other than the exclusive benefit of the participants and their beneficiaries. No part of the Trust's net earnings may inure to the benefit of any private person. The parties to the Trust Agreement are Taxpayer and the trustee of Trust.

Taxpayer will have exclusive authority and discretion to manage and control the assets of the Trust, but will delegate investment management of the Trust's assets to the trustee pursuant to the terms of the Trust Agreement. Under the terms of the Trust Agreement, Taxpayer may remove and replace the trustee of the Trust at any time, upon 30 days prior written notice. In the event of the trustee's removal or resignation, a successor trustee will be appointed by Taxpayer.

Taxpayer represents that the purpose of the Trust is to vest in the trustee responsibility for the protection and conservation of Trust property for the benefit of the Plan participants, their spouses and dependents, none of whom can share in the discharge of this responsibility for profit.

Trust provides that the Taxpayer may amend or terminate the Trust at any time provided that the Trust assets shall be used only for the purpose of providing health benefits to the participants of the Plan. In no event will the assets be transferred to an entity which is not a state, a political subdivision of a state, or an entity the income of which is excluded from gross income under § 115 of the Code.

LAW AND ANALYSIS

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated that

the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of public utilities or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign properly to conduct. In addition, pursuant to § 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under Subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under § 115 of the Code. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

The Trust provides health benefits to retired employees of the Taxpayer, a political subdivision of State. Providing health benefits to current and former employees constitutes the performance of an essential government function. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, the Trust performs an essential governmental function within the meaning of § 115(1) of the Code.

The income of the Trust accrues to the Taxpayer. Upon the dissolution of Trust, the use of its remaining funds to provide health benefits for retirees satisfies an obligation the Taxpayer has assumed with respect to providing health benefits to its employees. The benefit to the participating employees is incidental to the public benefit. See Rev. Rul. 90-74.

Section 301.7701-1(b) of the Procedure and Administration Regulations provides that the classification of organizations that are recognized as separate entities is determined under § 301.7701-2; § 301.7701-3 and § 301.7701-4 unless a provision of the Internal Revenue Code provides for special treatment of that organization.

Section 301.7701-4(a) provides that, in general, an arrangement will be treated as a trust if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

Taxpayer's contributions to the Trust are to be used to pay retiree health benefits for eligible retired employees and their spouses and dependents. The Trustee is charged

with the responsibility of the protection and conservation of Trust property for the benefit of the beneficiaries of the Trust. The beneficiaries of the Trust cannot share in the discharge of the Trustee's responsibility for the protection and conservation of property and, therefore, are not associates in a joint enterprise for the conduct of business for profit. Assuming that the Trust is recognized as a separate entity under § 301.7701-1, we conclude that the Trust is an ordinary trust under § 301.7701-4(a).

Section 6012(a)(4) of the Code provides that every trust having for the taxable year any taxable income or having gross income of \$600 or over, regardless of the amount of taxable income, shall make returns with respect to income taxes under Subtitle A.

Section 61(a)(1) of the Code and § 1.61-21(a)(3) of the Income Tax Regulations provide that, except as otherwise provided in Subtitle A of the Code, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

Section 106(a) of the Code provides that gross income of an employee does not include employer-provided coverage under an accident or health plan.

Section 1.106-1(a) of the Income Tax Regulations provides that the gross income of an employee does not include contributions which his employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by him, his spouse, or his dependents, as defined in § 152. The employer may contribute to an accident or health plan either by paying the premium (or a portion of the premium) on a policy of accident or health insurance covering one or more of his employees, or by contributing to a separate trust or fund (including a fund referred to in § 105(e)) which provides accident and health benefits directly or through insurance to one or more of his employees. However, if the insurance policy, trust or fund provides other benefits in addition to accident or health, § 106 applies only to the portion of the contributions allocable to accident or health benefits.

Coverage provided under an accident and health plan to former employees and their spouses and dependents is excludable from gross income under § 106. See Rev. Rul. 62-199, 1962-2 C.B. 32; Rev. Rul. 82-196, 1982-2 C.B. 53.

Section 105(a) provides that, except as otherwise provided in § 105, amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer.

Section 105(b) provides that, except in the case of amounts attributable to (and not in excess of) deductions allowed under § 213 (relating to medical expenses) for any prior

taxable year, gross income does not include amounts referred to in subsection (a) if such amounts are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by him for the medical care (as defined in § 213) of the taxpayer, his spouse, and his dependents (as defined in § 152 of the Code).

Based on the information submitted and representations made, we conclude as follows:

- (1) Trust income is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes of § 115(1). Accordingly, Trust's income is excludable from gross income under § 115(1) of the Code.
- (2) The Trust is classified as an ordinary trust within the meaning of § 7701(a) of the Code and § 1.301.7701-4(a) of the regulations. Trust is not required to file an annual income tax return under § 6012(a)(4) of the Code.
- (3) Contributions paid to Plan and payments made from Plan which are used exclusively to pay for the accident or health coverage of retired employees and their spouses and dependents (as defined in § 152 of the Code) are excludable from the gross income and do not constitute "wages" under § 3121(a)(2).

No opinion is expressed concerning the Federal tax consequences of Plan or Trust under any other provision of the Code other than those specifically stated herein. In particular, § 3.01(9) of Rev. Proc. 2007-3, 2007-1 I.R.B. 108, provides that the Service will not issue a ruling concerning whether a self-insured medical reimbursement plan satisfies the requirements of § 105(h) for a plan year. Accordingly, no opinion is expressed concerning whether Plan satisfies the nondiscrimination requirements of § 105(h) of the Code and § 1.105-11 of the regulations.

This ruling is directed only to the Taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Harry Beker, Chief
Health & Welfare Branch
Office of Division Counsel/Associate Chief
Counsel
(Tax Exempt & Government Entities)

cc: